

INTERNAL AUDIT WITHIN THE SYSTEM OF FINANCIAL CONTROL

Ruslana Dimitrova^{*}

1. Introduction

Internal audit is constantly evolving and improving taking into account the needs of businesses and stakeholders. For practice, it is important the internal audit to be studied in terms of the theory of financial control in order to differentiate its functions within the system of the financial control and governance processes.

Object of study: internal audit and its functions.

The objective of this article is: by theoretical justification of the nature of internal audit functions and empirical study of the practice to formulate conclusions and recommendations for its improvement within the system of financial control.

1. To achieve the objective, the following tasks should be implemented:
2. To study the role and function of internal audit within the system of financial control.
3. To determine the nature and functions of internal audit.
4. To examine how the functions of internal audit are implemented in practice in Bulgarian enterprises and the opportunities for its improvement.

2. Place and role of internal audit within the system of financial control

Historically, concepts of financial control have occurred at different times and each of them has influenced the development of internal audit by determining its role, functions and responsibilities. Review of scientific literature [1–10] allowed them to be systematized in two directions: the first concept considered the financial control as an organized activity, and the second concept defines it as function of management. For this end, theory of control uses different approaches to study the nature of financial control.

One group of authors [4] used the legal approach to clarify the nature of financial control as an organized activity. Originally, financial control has been associated with verification of documents, and according to current understanding, it is perceived as an activity where different methods for qualitative and quantitative evaluation of the objects of financial control are applied to confirm the compliance with existing regulations and laws.

Second group of authors [11] used the governance approach and present financial control as a stage or function of management, which purpose is to assess the implementation of management decisions and goals using the tools of analysis and accounting.

Third group of authors [3] used cybernetic approach to present the financial control as a way of receiving feedback through procedures, testing and integration of control systems in business processes for the purpose of efficient implementation.

Another group of authors [12; 13; 15] explored financial control as an activity for minimization of risk arising in the management of its objects from the perspective of risk management theories. They also used a system approach, but the control system is viewed not in terms of “management – obedience” principle, but contrary to the necessary for the control – control environment, risk assessment; information and communication; control procedures and monitoring.

^{*} © Dr. Ruslana Dimitrova; Assistant Professor; Accounting and Control Department; University of Economics; Varna; Bulgaria; Email: <ruslana.dimitrova@ue-varna.bg>.

Approaches applied to study the financial approach, history and development of internal audit [16] allow the role, functions and responsibilities of the internal audit within the system of financial control to be summarized as follows (Tab. 1).

Tab. 1. Role, functions and responsibilities of internal audit in the system of financial control

Period	Approaches to study the financial control	Role if internal audit	Functions of internal audit	Responsibility of internal auditor
In the early 20 th century	Legal approach	Confirmation of reporting records and the status of assets and liabilities	Control. Information. Regulatory (influential).	Not specially defined
20 th century 20's/40's	Governance approach	Testing and evaluation of control systems	Information. Control. Evaluation Regulatory (influential).	To Operations manager
20 th century 40's/50's	Cybernetic approach	Testing, evaluation and analysis of accounting information and information systems	Information. Control. Evaluation Analytical.	Administrative to management
20 th century 90's	Risk-oriented approach	Identifying. Testing. Assessment and advice on financial risk	Information. Control. Evaluation Analytical. Advisory.	Administrative functional

Professional audit and accounting associations when developing various control frameworks of systems of internal, including financial control (1, 2, 3) use risk-oriented approach that allows the internal audit to be positioned within the organizational structure in a way that establishes itself as an independent evaluation and consulting activity.

In practice, this is achieved by its functions, as revealing of their composition and content is a prerequisite for:

- Efficient organization of work of the internal audit department;
- Use of available resources in the execution of audit engagements and consultations;
- Determining the role and place of internal audit within the system of financial control.

3. Function of internal audit – theory and practice

Scientific literature presents different understandings of the nature and functions of internal audit.

Some authors [17], analyzing the definition of internal audit of The IIA [15], assume that it fulfils two main functions: control and information and advisory.

Other authors [8] considering the content of the problems solved by internal audit in practice, assume that it fulfils coordination, advisory, control, evaluation, analytical, preventive and information functions.

The third group of authors [18] assume that the internal audit fulfills the following functions: confirming, information, analytical, project-methodological, direct and indirect feedback, protective.

To define the function of internal audit and to differentiate the responsibility of internal auditors in terms of theory and practice, its relationship with and difference from internal control is of importance.

Unlike internal control which is a governance function, internal audit is an evaluation activity. It also, like the internal control, can be viewed as a process that is organized differently. Internal control can be organized both in the enterprise and outside it, because it is relatively independent from the governance process.

In terms of methodology, these features are important and should be taken into account when differentiating the functions of the internal audit from those of the internal control.

In their essence, the functions of internal audit can be defined as: activities specific in their content and purpose, which are directly related to the competence of internal auditors and allow the mission and strategy of development of the internal audit to be adapted and coordinated with the priorities of risk management, financial control and business development strategies.

It is methodologically more sustained to be assumed that practically the internal audit performs the following functions:

- Information – evaluation – internal auditors not only use, but also create a qualitatively new information about the state of the internal control and risk management systems, audits and business processes and risks associated with them. Internal auditors report collected, processed, analyzed and evaluated information in an appropriate form to parties concerned. For this purpose, they perform actions and procedures to identify and evaluate risks, associated with internal control systems, ongoing business processes and changes in internal and external environment; internal control and risk management system assessment; assessment of controls for the protection of assets and effective use of resources; evaluation of IT and information flows; evaluation of the state of audits, business processes and risks associated with them; assessment of controls for protection of assets and their effective use; analysis and processing of collected data in a form appropriate for the purposes of governance, risk management and control; effective efficient and reliable information feedback through established communication channels and reporting to management, Board of Directors and Audit Committee.
- Control function – it includes activities and procedures for monitoring of internal control systems and risks associated with them; compliance with applicable law and the internal rules and regulations and codes of conduct; monitoring the implementation of recommendations, measures undertaken to update the risk control and management systems; interaction with the external auditors and regulators; fraud prevention and detection of fraud and corrupt practices.
- Methodological function – includes activities related to staff training to implement specific control activities and risk assessment; assistance in the development of procedures and methods for risk assessment; assistance for updating the internal regulations and standards; establishing a suitable internal environment for the operation of an internal audit department; qualification courses, programs and training for continuing professional development.
- Advisory function – includes advising operational management on issues to improve control systems and risk management system and risk assessment; senior management on specific issues within the competence of internal auditors related to strategy assessment and corporate management; Audit Committee on specific projects and programs.

Successful development of internal audit in Bulgarian enterprises is determined by its functions.

For this purpose, an empirical study in the form of a survey has been made to determine the state of the activities, performed by the internal audit.

The survey involved 53 enterprises. A sample of seven enterprises in the category of public interest companies (large companies) has been made of those that have given a positive answer. The major criterion was reliability of the source of information. The activities performed by the internal audit in three banks have been compared. In this way, the actually functioning internal audit in Bulgarian enterprises and banks has been analyzed and compared, which is important for our practice and theory.

To distinguish the functions of internal audit, the survey included questions to assess the type of activities it performs. Responses were evaluated in three grades, insignificantly advanced activities, moderately advanced activities, priority advanced activities. The comparison is between enterprises (large companies) and banks. The results are summarized by the author in bar charts (Fig. 1; Fig. 2).

The analysis of the responses of the questions concerning the activities performed by the internal audit has led to the following conclusions:

1. The functions developed in the surveyed enterprises and banks are as follows: information-evaluation function; control function; advisory function and methodological function.
2. Information-evaluation function is the best developed one. Priority advanced activities are: assessment and monitoring of internal control and risk management systems; assessment of controls for the protection of assets; assessment of effectiveness of the use of resources and business processes; evaluation of management decisions, implementation of recommendations, strategies and effectiveness of corporate governance.
3. Activities which are not sufficiently advanced, especially in enterprises are: assessment of IT and security of information systems and evaluation of internal regulations.
4. The analysis of internal audit methodological and control functions demonstrated that there are activities related to these functions, which are developed: participation in training, methodological assistance, coordination and interaction with external auditors and regulators and fraud investigation.
5. In the surveyed enterprises and banks positive assessment can be given to the state of advisory function.
6. Comparative analysis shows that internal audit functions in the surveyed banks are one level more advanced than in the surveyed enterprises.

In practice, the importance of internal audit is defined by the activities it performs related to risk assessment in financial sector and by the confidence the management has in it.

To this end, the survey included questions to assess the importance of internal audit according to types of activities in five degrees, where 1 and 2 is minor, 3 moderate, 4 and 5 significant. Results are summarized by the author in bar charts (Fig. 3; Fig. 4).

The analysis of the responses of the importance of the internal audit in risk assessment showed the following (Fig. 3):

In banks, when assessing the risk, internal auditors focus on financial activity, frauds, IT, operations, human resources management, and in enterprises – internal auditors focus on IT, fraud, operations and financial activity.

The analysis of the responses for the confidence put in internal auditors by the management showed the following (Fig. 4):

1. The degree of confidence in internal auditors varies in enterprises and banks. In banks confidence in internal auditors is definitely bigger.
2. The management prefers the internal audit to be carried out by the Internal Audit Department, but still in the financial sector, the internal auditor lies in the shadow of external auditors and management.

The conclusion is as follows: It is recommended that in order to be credible and to be useful in the studied areas, internal auditors should:

- Offer the parties concerned services which external auditors cannot provide, do not want to provide or provide at a very high price;
- Use all available opportunities for communication and interaction with the management to coordinate their actions, plans and programs in the field of risk management, financial control, quality of accounting information and fraud;
- Develop meaningful activities such as information-evaluation and also control, methodological and advisory function.

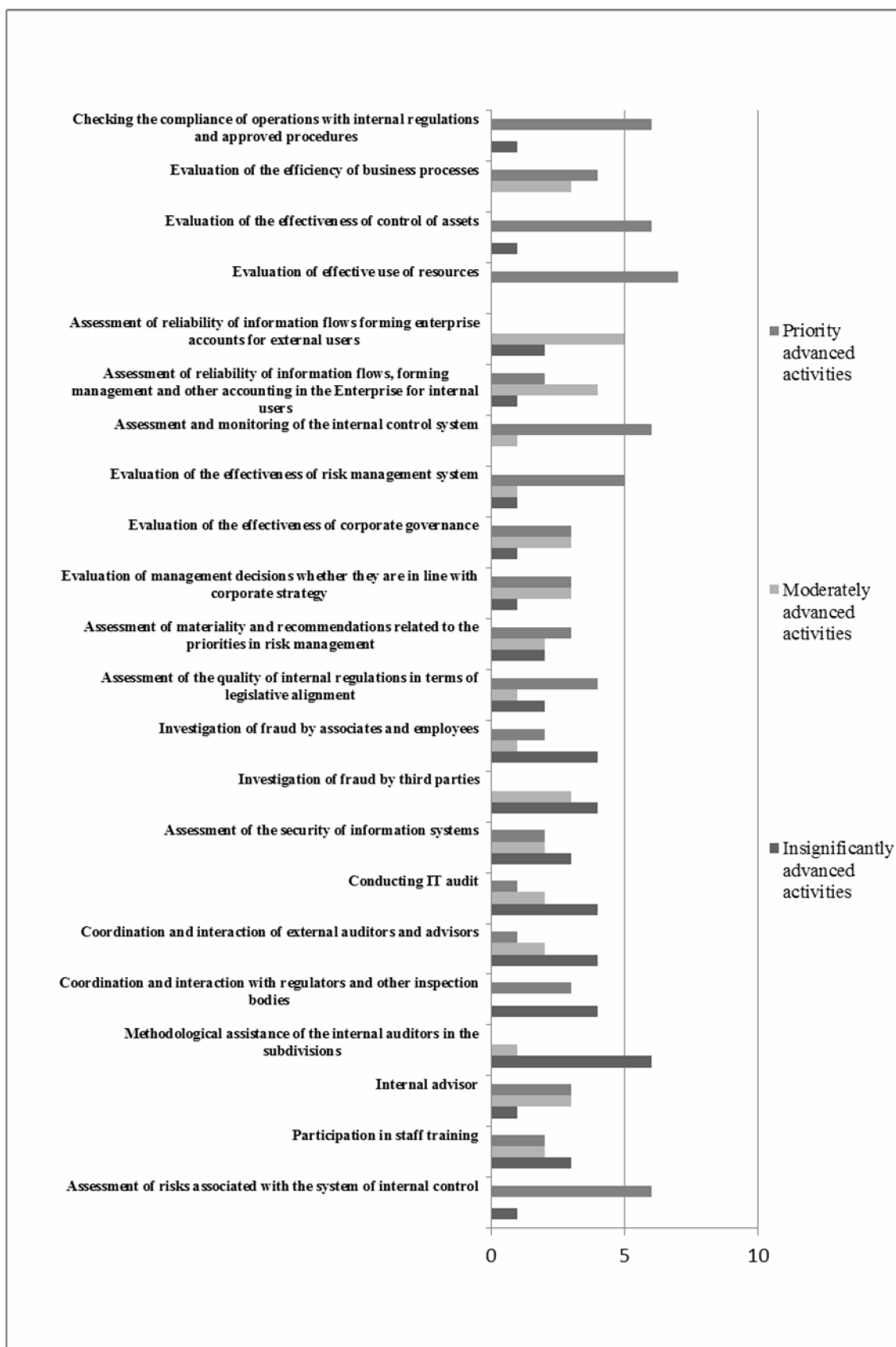


Fig. 1. Summarized bar chart of internal audit activities performed in enterprises

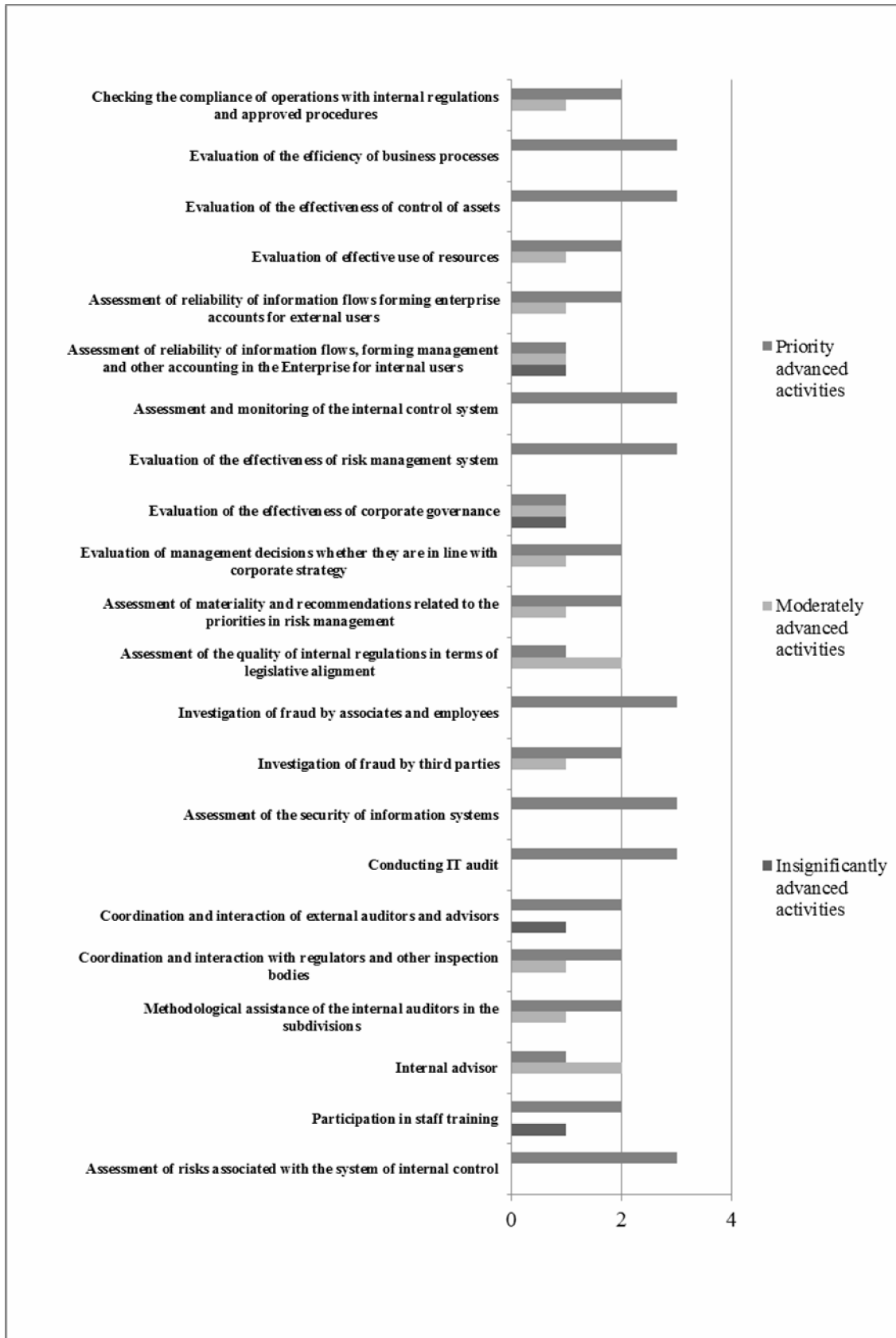


Fig. 2. Summarized bar chart of internal audit activities performed in banks

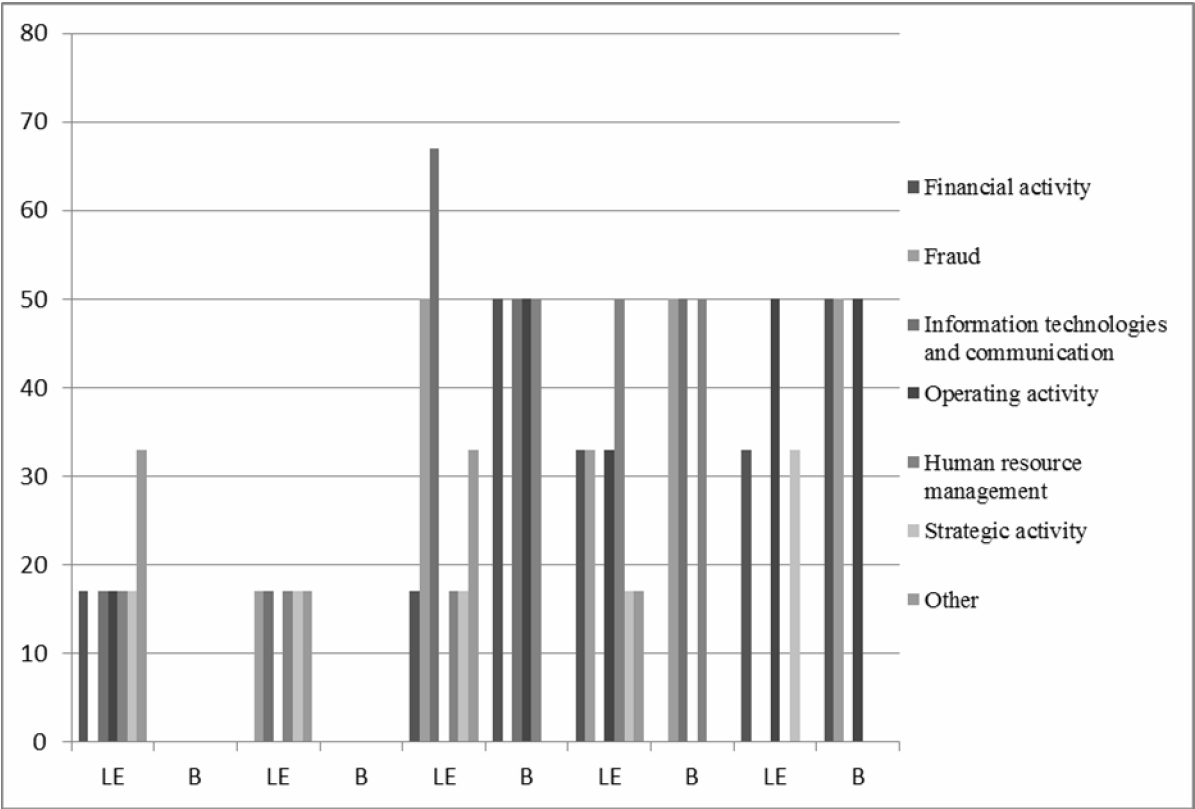


Fig. 3. Role of internal audit in risk assessment

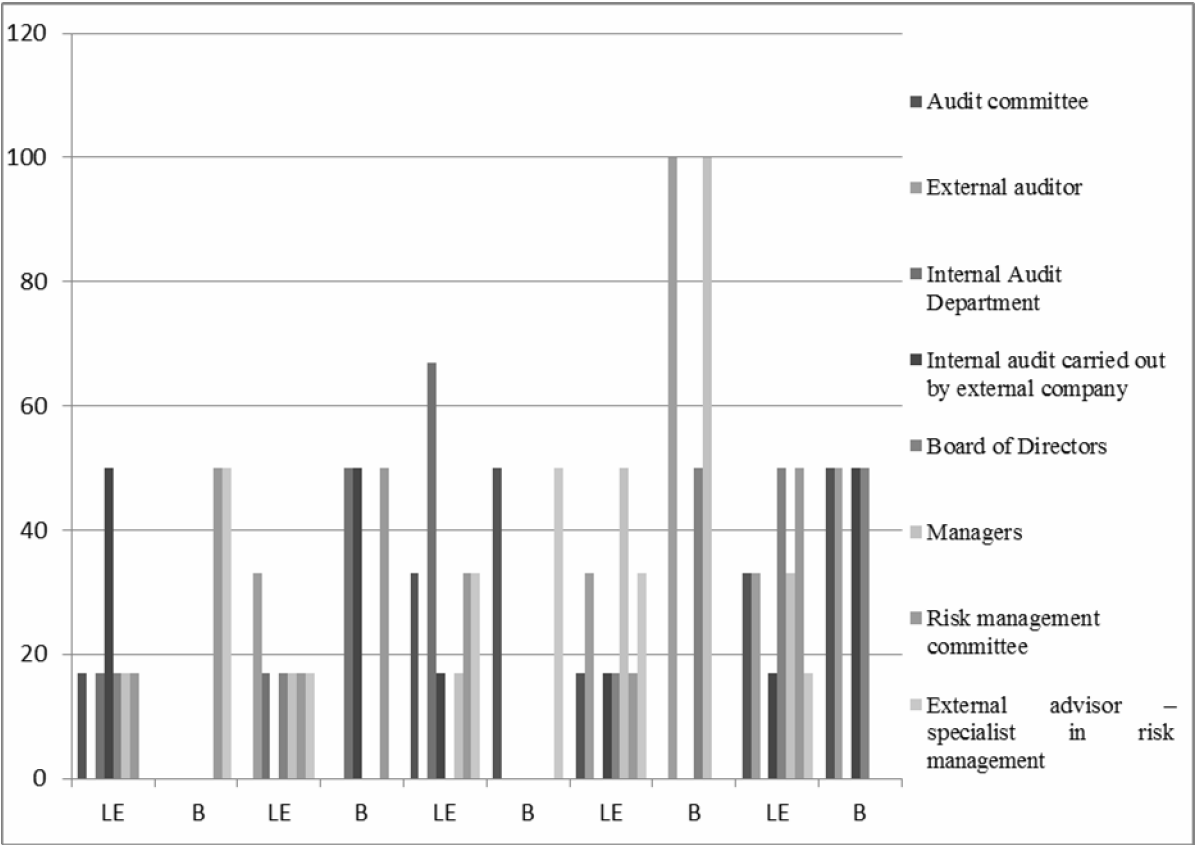


Fig. 4. Degree of importance of structures, which the management has confidence in when assessing the risk

References

1. COSO [Electronic source]. – Access: www.coso.org.
2. Арабян К. Теория и методология финансового контроля / К. Арабян. – М.: МЭСИ, 2012.
3. Бурцев В. Внутренний контроль: основные понятия и организация проведения. Менеджмент в России и за рубежом / В. Бурцев. – Vol. 4. – 2002.
4. Грачева Е. Государственный финансовый контроль как важнейший инструмент обеспечения публичных интересов в условиях рынка / Е. Грачева // *Lex Russica*. – Vol. 6. – 2009.
5. Динев М. Контрол в социалното управление / М. Динев. – С.: Тракия-М, 1999.
6. Добрев Д. Ръководство за контрол, ревизии и експертизи на стопанските предприятия / Д. Добрев. – С.: Печатница С. М. Стойков, 1933.
7. Донеv К. Теория на финансовия контрол / К. Донеv, Ж. Герджиков, Р. Димитрова. – Варна: НИИУ, 2010.
8. Кеворковой Ж. Внутренний аудит / Ж. Кеворковой. – М.: ЮНИТИ, 2013.
9. Стоянов И. Г. Финансовият контрол – важен способ за обезпечаването та законността в сферата на публичните финанси / И. Г. Стоянов. – *Правна мисъл*. – Vol. 1. – 2002.
10. Шохин С. О. Проблемы и перспективы развития финансового контроля в Российской Федерации / С. О. Шохин. – М.: Финансы и статистика, 1999.
11. Кунц Г. Управление системный и ситуационный анализ управленческих функции / Г. Кунц, С. С. О’Доннел. – М.: Прогресс, 1981.
12. CICA [Electronic source]. – Access: www.cica.ca.
13. Colber J. L. A Comparison of Internal Controls: COBIT, SAC, COSO and SAS 55/78 [Electronic source] / J. L. Colber. – Access: <http://gaton.uky.edu>.
14. Oprosko J. The Importance of Financial Controls [Electronic source] / Oprosko J. – Access: <http://www.tiia.org/Int Auditor/in the-industry>.
15. The IIA / Definition of Internal Auditing [Electronic source]. – Access: <http://www.theiia.org>.
16. Милър Р. Съвременен вътрешен одит – теория и практика / Р. Милър. – С.: АСПО ЕООД, 2007.
17. Новоселов И. Цели, функции и задачи внутреннего аудита российских компании [Электронный ресурс] / И. Новоселов. – Режим доступа: <http://cyberlenica.ru>.
18. Хорохордин Н. Методология внутреннего аудита в организации / Н. Хорохордин // *Аудиторские ведомости*. – Vol. 6. – 2006.

Summary

The results of the empirical study of internal audit function in Bulgarian enterprises allow the following conclusions and recommendations to be made: 1) In the surveyed enterprises and banks, information – evaluation function of internal audit is best developed; 2) Not sufficiently developed are activities to ensure quality and richness in content of internal audit control and methodological functions; 3) Advisory function is moderately advanced and depends on internal auditors and management’s professional skills; 4) To differentiate and define the role and place of internal audit within the system of financial control it needs to be improved in several direction:

- Organizational and legal status – to this end it is advisable the mission and strategy of development of internal audit to be defined ensuring its independence with appropriate channels of reporting and interaction with the Audit Committee;
- Scope and content of audit engagements – it is recommended they to be focused on main risks in the systems of financial control, risk management and business development strategies;
- Improving internal audit methodology and technology – this can be achieved by adapting and coordinating the audit plan with changes in the organization, financial risks, methods of external independent audit, use of software and self-assessment of risk and control in the audit activities of internal auditors.

Keywords: internal audit; function of internal audit; financial control.

JEL classification: F30

UD classification: 658:68.231

Date of acceptance: 22.07.2014.